

Before the
Federal Communications Commission

Washington, D.C. 20554

In the Matter of)	
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)	
Review of the Commission's Rules Regarding)	WC Docket No. 03-173
the Pricing of Unbundled Network Elements)	
and the Resale of Service by Incumbent Local)	
Exchange Carriers)	

COMMENTS OF AMERICATEL CORPORATION

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Introduction & Summary

Americatel Corporation ("Americatel"),¹ through counsel, respectfully submits its comments in response to the *NPRM* issued by the Federal Communications Commission ("FCC" or "Commission") in the above-captioned proceeding.² Americatel opposes any changes to the Commission's pricing rules for Unbundled Network Elements ("UNEs") that are currently based on the Total Element Long Run Incremental Cost ("TELRIC") for the provision of a UNE. The existing rules, which were affirmed by the United States Supreme Court, are working to bring competition to local markets. They must, therefore, be protected against repeal.

¹ Americatel, a Delaware corporation that is a subsidiary of ENTEL Chile, is a common carrier providing domestic and international telecommunications services. ENTEL Chile is the largest provider of long distance services in Chile and also provides wireless and competitive local services in the Chilean market. Americatel also operates as an Internet Service Provider ("ISP"). Americatel specializes in serving Hispanic communities throughout the United States, offering presubscribed (1+), dial-around, and prepaid long distance services, as well as private line and other high-speed services to its business customers. The majority of traffic carried by Americatel is dial-around in nature.

² *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, WC Continued on following page

The Commission has decided to reexamine the appropriateness of its pricing rules for UNEs. Those rules are currently based on the TELRIC for the provision of a UNE and were first adopted in 1996 in the *Local Competition Order*.³ The FCC is now reevaluating its UNE pricing rules in order to determine “whether [its] pricing methodology is working as intended and, in particular, whether [the rules are] conducive to efficient facilities investment.”⁴ The Commission is apparently concerned that its TELRIC pricing rules are distorting the FCC’s “intended pricing signals by understating forward-looking costs” and, thereby, thwarting “one of the central purposes of the Act: the promotion of facilities-based competition.”⁵

Critics of TELRIC-based pricing (mainly the Bell Operating Companies (“BOCs”) that stand to lose retail market share to UNE-based competition) argue that the TELRIC cost study framework generates UNE rates that are too low. The BOCs claim that these “low-ball” prices, in turn, cause competing carriers to provide local services using UNEs, rather than by constructing their own network facilities, and also provide a disincentive for the BOCs to invest in new network technology. Essentially, the BOCs are seeking a regulatory blessing for

Continued from previous page

Docket No. 03-173, FCC 03-224 (rel. Sept. 15, 2003) (“*NPRM*”).

³ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition Order*), *aff’d in part and vacated in part sub nom. Comp. Tel. Assoc. v. FCC*, 117 F.3d 1068 (8th Cir. 1997) and *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff’d in part and remanded, AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (1999); *on remand, Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000) (*Iowa Utilities II*), *reversed in part sub nom. Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002) (*Verizon v. FCC*).

⁴ *NPRM*, at ¶3.

⁵ *Id.*

them to avoid any requirement to unbundle those new investments for competitors.⁶

The BOCs' competitors, not surprisingly, tell another story. Even during 2001 and 2002, which were generally economic depression-level years for the telecommunications industry in general and for competitive local exchange carriers ("CLECs") in specific, competitive carriers continued to make significant investments in network facilities. Competitive carriers, excluding cable television operators, spent approximately \$17 and \$7.4 billion in 2001 and 2002 respectively.⁷ The BOCs invested approximately \$35 and \$22 billion in 2001 and 2002 respectively.⁸ One cannot argue with a clear conscience that the expanded use of UNEs by CLECs has dried up investment in network facilities by either incumbents or new entrants.

The chief change in the TELRIC pricing rules proposed in the *NPRM* would be to set UNE prices based on the costs of a BOC's existing network, rather than on the costs of a "hypothetical" network, "using the least-cost, most-efficient technology currently available."⁹ The BOCs have generally despised the existing rule, arguing against it all the way to the Supreme Court. However, as the Commission is well aware, the High Court held "that the Commission's decision to adopt a forward-looking cost methodology was a reasonable interpretation of the [applicable] statute."¹⁰

⁶ *Id.*, at ¶5.

⁷ Association for Local Telecommunications Services ("ALTS"), "The State of Local Competition 2003," at 11 (April 2003).

⁸ *Id.*

⁹ *NPRM*, at ¶17; 47 C.F.R. § 51.505(b)(1).

¹⁰ *NPRM*, at ¶5.

Americatel is limiting its initial comments in this proceeding to several key points. The first point is that the Commission must consider that the BOCs have a history of supporting any economic theory for calculating the cost for services that produces prices that can impede competition. Hence, the Commission should be wary of any and all economic evidence from the BOCs. Rather than rely on the BOCs' specious evidence in support of rule changes that would, in turn, weaken local competition, the Commission should simply decline to amend its TELRIC rules altogether.

However, in the event that the FCC were to permit the BOCs to price UNEs based on historical costs, the FCC must also require the BOCs to reduce those costs to reflect the results of the Continuing Property Records audit. As the Commission is well aware, that audit concluded that the BOCs' accounting records overstate their investments in network facilities and, therefore, the costs for providing services, including UNEs.

Moreover, as discussed below, while the interstate portion of the Continuing Property Records audit has resulted in the downward adjustment of the BOCs' interstate access charges, there is no evidence that the intrastate portion of that audit has been reflected in the BOCs' UNE rates. Were the FCC to permit the BOCs to price UNEs based on their embedded networks, while ignoring this problem of overstated costs, the BOCs' UNE rates would be excessive, which, in turn, would send another incorrect economic "make/buy" signal to CLECs. The overpricing of UNE rates would likely cause CLECs either to contract in size or to invest in their own network facilities in situations where they should be purchasing UNEs from the BOCs, thus, causing the CLECs to waste their limited capital resources and protecting the BOCs' remaining (but still very substantial) local market power.

The BOCs Have Demonstrated “Great Flexibility” Concerning Cost Study Methodologies Over the Years in Order to Stifle Competition

Recently, the BOCs have generally taken the position that UNE prices must be calculated “using the incumbent’s past investment in the [UNE] and the means of providing it,” *i.e.*, historical cost of the embedded networks.¹¹ That argument was rejected by the Supreme Court, which held, in *Verizon v. FCC*, that the Commission’s focus on incremental costs for the most efficient network was reasonable.¹² Indeed, the Supreme Court commented that the BOCs’ historic costs might not even be accurate.¹³

Having lost their argument before the Supreme Court, the BOCs are now trying to persuade the Commission that its TELRIC pricing standards for UNEs, which were adopted in 1996, are flawed because TELRIC-based prices for UNEs stifle investment in the network—by both the CLECs and the BOCs.¹⁴ According to BOC rhetoric, CLECs have failed to invest in their own networks because they can purchase UNEs at lower cost.¹⁵ Similarly, the BOCs state that they are not investing in their own networks because they do not make large enough profits on UNEs. (However, the real truth is more likely that the BOCs only want to invest in network

¹¹ *Verizon v. FCC*, 535 U.S. at 507.

¹² *Id.*

¹³ *Id.*, 535 U.S. at 512.

¹⁴ SBC Communications (“SBC”) even went so far as to “persuade” the Illinois Legislature and Governor Rod Blagojevich to approve legislation that contravened the FCC’s rules and the requirements of the Communications Act of 1934, as amended (“Act”) in order to set higher UNE rates. Fortunately for competition and consumers, the courts stepped in to void the Illinois statute and bring SBC’s Illinois UNE prices back to correct levels. *Voices for Choices v. Illinois Bell Tel. Co.*, 2003 U.S. Dist. LEXIS 9548 (N.D. Ill. June 9, 2003), *aff’d sub nom. AT&T Communications Corp. v. Illinois Bell Tel. Co.*, No. 03-2735 *slip op.* (7th Cir. Nov. 10, 2003).

¹⁵ *But see*, n.7, *supra* and accompanying text.

facilities that will be used to provide their own retail services.) These alleged “economic truths” justify revision of the TELRIC rules in a manner that would base UNE rates on the BOCs’ historic costs, according to the BOCs.

The encouragement of investments by both the BOCs and their competitors is, indeed, a critical goal that the Commission is appropriately addressing in the *NPRM*. Moreover, but for the BOCs’ checkered history of using whichever economic theory best protects their markets at the time, there would probably be reason for the Commission to take the BOCs’ investment incentive arguments seriously. However, the BOCs have no compunction about switching economic theories whenever a new theory would protect their market shares. The BOCs’ current argument that the FCC must use historical costs to price UNEs, which was already rejected by the High Court in the *Verizon v. FCC* case, is contrary to the BOCs’ earlier arguments that historical costs should not be used for pricing services. The BOCs are still using this argument today in the hope that it can help thwart local competition by increasing UNE prices.

History demonstrates that the BOCs tend to support whichever cost study methodology produces prices that dampen competition. At the present time, they seek UNE prices based on the costs of their legacy networks because that methodology produces higher rates for UNEs that are used by the BOCs’ competitors than would the FCC’s existing TELRIC methodology, which is based on costs for the most efficient network. Today’s BOC message is: Price UNEs based on actual historic costs. However, one need not travel too far back into the 20th Century to see examples where the BOCs advocated to the FCC that, because of growing competition, the BOCs must be allowed to price services based on forward-looking costs and even “hypothetical networks.” This inconsistency in positions is clear.

The Bell System, which included the BOCs prior to their 1984 divestiture from AT&T, aggressively supported the use of incremental costs for pricing services in a competitive market. For example, in FCC Docket 18128, which considered prices for the Bell System's bulk private line service (TELPAK), the Commission's *TELPAK M&O* characterized the Bell Systems' position as follows: "Bell maintains that the relevant costs to be considered are long-run incremental costs (LRIC), not fully allocated or fully distributed costs."¹⁶ The Bell System went so far as to argue that fully distributed cost studies (which are based on a carrier's historical costs) produce rates that are "anti-competitive and create[] a protective umbrella for [the Bell Systems'] competitors."¹⁷

Also, when the Bell System sought to extend its 24-city Dataphone Digital Service ("DDS") to additional cities, rather than base its cost and rate projections on its existing DDS network, the Bell System calculated its costs for the expanded service offering based on a *hypothetical* 96-city DDS network.¹⁸ Not surprisingly, at the time the Bell System proffered costs from a hypothetical network to the FCC, the Bell Systems' DDS service faced competition from a competing carrier, Data Transmission Company (Datran).¹⁹

Americatel's purpose in discussing these older cases is simply to remind the

¹⁶ *AT&T Long Lines Dept., Revisions of Tariff F.C.C. No. 260 Private Line Services, Series 5000 (TELPAK)*, Memorandum Opinion & Order, 62 FCC 2d 587, at ¶30 (1976) ("*TELPAK M&O*").

¹⁷ *Id.*, at ¶32

¹⁸ *AT&T, Investigation into the Lawfulness of Tariff F.C.C. No 267, Offering a Dataphone Digital Service Between Five Cities*, Final Decision & Order, 62 FCC 2d 774, at ¶42 (1977).

¹⁹ Interestingly, during the pendency of the FCC's investigation of the Bell Systems' DDS offering, Datran became compelled to file a Section 214 application for an indefinite emergency application to discontinue all of its common carrier services and later filed for bankruptcy. *Id.*, at ¶776, n.3.

Commission of the BOCs' "intellectual flexibility" with respect to advancing whichever economic theory would permit the BOCs to price services to minimize competition. The Commission has long been concerned about the BOCs' ability to engage in "strategic pricing" whereby the BOCs, left to their own devices, would price various services to forestall competition. For example, in denying US West's (now Qwest Communications) request to be treated as a non-dominant carrier in Phoenix for Special Access services, the Commission stated the following:

Without such regulation, and in the absence of competition, the BOC petitioners discriminate against certain customers by charging higher rates to those that lack competitive alternatives. For example, without our rate structure and rate level regulations, the BOC petitioners could engage in strategic pricing by offering reductions in rates for special access and high capacity dedicated transport services where they face competition and higher rates for these services where they face little competition. This sort of strategic pricing discriminates among consumers, not on the basis of cost characteristics, but on the basis of the availability of competitive alternatives. Moreover, it deters entry by competitors.²⁰

Ramsey Pricing by Another Name?

The BOCs essentially seek reversal of the FCC's earlier decision not to permit the BOCs to use Ramsey Pricing for UNEs.²¹ Ramsey Pricing allocates a firm's overhead and other common costs to multiple products or services in an inverse relationship to demand for such products or services. Those products or services with the most inelastic demand, often because of a lack of competitive substitutes, bear the highest proportion of the overhead or common costs

²⁰ *Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, Memorandum Opinion & Order, 14 FCC Rcd 19947, at ¶34 (1999).

²¹ *Local Competition Order*, at ¶¶645 *et seq.*

when Ramsey Pricing concepts are followed.²² Many economists believe that Ramsey Pricing works best when the business utilizing it is a monopolist or near monopolist.²³

At this point in the debate, the BOCs would likely retort that the local exchange market is fully competitive. However, the BOCs' empty rhetoric on the "high level" of local competition has not fooled everyone. For example, Judge Posner from the Seventh Circuit Court of Appeals, while agreeing with Wisconsin Bell, Inc.'s (*i.e.*, SBC Wisconsin) position that the Act preempted an order of the Wisconsin Public Service Commission requiring Wisconsin Bell to file local interconnection tariffs rather than be permitted to negotiate interconnection agreements with CLECs, recently and readily acknowledged the BOCs' ongoing market power in the local market.

Local telephone companies such as Wisconsin Bell have a degree of monopoly power because of the cost to a competitor of duplicating the grid of telephone wires and switching equipment that constitutes a local telephone network. The competitor will find it difficult to compete unless it is interconnected with the local network.²⁴

The plain and simple truth is that the BOCs continue to have sufficient control of the local market so as to permit them to use Ramsey Pricing concepts for pricing UNEs unless prevented

²² See, e.g., *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities; and Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates*, Report & Order, 2 FCC Rcd 1298, at ¶113, n.219 (1987) (subsequent history omitted).

²³ Alfred E. Kahn & William B. Shew, *Current Issues in Telecommunications Regulation: Pricing*, 4 YALE J. on REG. 191, 248 (1987) ("The standard formula for Ramsey pricing assumes a monopoly supplier. The competition in telecommunications markets is likely to alter the prices that satisfy the Ramsey principle. How it alters them will depend on whether regulation is confined to the incumbent firm or extended to competitive entrants as well.").

²⁴ *Wisconsin Bell, Inc. v. Bie*, 340 F.3d 441, 442 (7th Cir. 2003).

from doing so by the Commission.

The BOCs' proposal would force their competitors to bear the costs of the inefficiencies in the BOCs' networks and back office operations in the form of higher rates for UNEs than under the proposal set forth in the *NPRM*. At the very same time, the BOCs would likely take whatever action was necessary to ensure that their competitive retail products did not bear the costs of network inefficiencies and unreasonably large contributions to the BOCs' overhead expenses. The Commission must simply reject the BOCs' latest attempt to minimize local competition by increasing rates for UNEs.

The BOCs' Historical Costs Overstate Their True Costs of Providing UNEs

As the Supreme Court noted in the *Verizon v. FCC* case, the BOCs' proffered historical costs for providing UNEs may not even be accurate.²⁵ The Commission is well aware that there is ample evidence to support the Court's belief. For example, the FCC conducted substantial audits of the BOCs' Continuing Property Records for various Central Office Plant accounts. The Commission's auditors found that the BOCs' accounting records did not meet the requirements of the FCC's accounting rules (47 C.F.R., Part 32) and that the BOCs' regulated investment accounts were overstated by approximately \$5.2 billion.²⁶

In response to its Staff's findings, the FCC opened a notice of inquiry into the

²⁵ See n.13, *supra*.

²⁶ *Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit; Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit; Bell Atlantic (South) Telephone Companies' Continuing Property Records Audit; BellSouth Telecommunications' Continuing Property Records Audit; Pacific Bell and Nevada Bell Telephone Companies' Continuing Property Records Audit; Southwestern Bell Telephone Company's Continuing Property Records Audit; US West Telephone Companies' Continuing Property Records Audit*, Notice of Inquiry, 14 FCC Rcd 7019 (1999).

BOCs' accounting practices and the Continuing Property Records audit results.²⁷ The BOCs generally argued that the FCC auditors' conclusions were erroneous. Many other parties agreed with the conclusions of the FCC's auditors.

Before the Commission completed its inquiry into the BOCs' Continuing Property Records audit results, the BOCs agreed to a significant reduction and restructuring of their interstate access charges in exchange for the FCC's termination of its investigation into the BOCs' Continuing Property Records.²⁸ Thus, interstate ratepayers (long distance carriers and their customers) received some level of price cuts to reflect the discovery of the BOCs' overstated plant investments and depreciation expenses.

It is critical to the fair resolution of this proceeding, however, to note that the apparent overstatement of the BOCs' plant investment accounts by approximately \$5.2 billion was not a post-separations figure. Therefore, while the *CALLS Order's* access charge rate reductions may well have constituted a pass-through of the interstate portion of the BOCs' phantom costs, the *CALLS Order*, obviously, did not affect the intrastate portion of those costs. The BOCs' intrastate customers, which would include CLECs using UNEs, would pay inflated rates for those UNEs if the FCC were to amend its TELRIC rules in a manner that would calculate UNE costs based on the BOCs' books of account and not also force the BOCs to

²⁷ *Id.*

²⁸ *Access Charge Reform; Price Cap Performance for Local Exchange Carriers; Low-Volume Long Distance Users; and Federal-State Joint Board on Universal Service; Sixth Report & Order* In CC Docket Nos. 96-262 and 94-1, *Report & Order* in CC Docket No. 99-249, *Eleventh Report & Order* in CC Docket No. 96-45, *Second Further Notice of Proposed Rulemaking*, *Notice of Inquiry*, *Notice of Proposed Rulemaking*, and *Further Notice of Proposed Rulemaking Pertinent to this Sixth Report and Order*, *Report and Order*, and *Eleventh Report and Order*, 15 FCC Rcd 12962 (2000) ("*CALLS Order*"), *reversed & remanded in part, Texas Office of Public Utility*

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eliminate their overstated plant investments. Furthermore, to the extent that the BOCs' Continuing Property Records for various Central Office Plant accounts were erroneous, there exists a strong likelihood that the BOCs' Continuing Property Records for other plant accounts are similarly erroneous.

In sum, there exist reasonable grounds for regulatory agencies to presume that any intrastate cost study for UNEs that is based on the BOCs' investments in their legacy networks is likely to be overstated. If so, the overstatement of plant investments would likely result in UNE rates that over-state the BOCs' depreciation expenses and necessary return on investment components thereto. Taking this reasoning further, to the extent that UNEs are priced excessively, the FCC will be allowing the BOCs to send an incorrect "make/buy" signal to the CLECs. Under those circumstances, CLECs would invest in their own facilities in instances where the *proper* economic signal from UNE prices would have lead CLECs to provide services through UNEs. The FCC's concern about proper "make/buy" decisions (*i.e.*, investments in network facilities) should be as applicable to this situation as it was to the possibility that UNEs would be over-consumed.

Conclusion

For the reasons discussed above, the Commission should decline to amend its TELRIC cost formula rules for pricing UNEs. The existing rules, which were affirmed by the

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Counsel v. FCC, 265 F.3d 313 (5th Cir. 2001), *on remand*, 18 FCC Rcd 14976 (2003).

United States Supreme Court, are working to bring competition to local markets. They must, therefore, be protected against repeal.

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CERTIFICATE OF SERVICE

I, Lila A. Myers, do hereby certify that the foregoing **COMMENTS OF AMERICATEL CORPORATION** was served on this 16th day of December, 2003 upon the following by e-mail:

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